VIRGINIA ENERGY CORPORATION

1997 ANNUAL REPORT

CORPORATE INFORMATION

Head Office

Virginia Energy Corporation
1500, 630 - 6th Avenue SW
Calgary, Alberta
Telephone: (403) 205-3722
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Board of Directors

Kenneth S. Meek
David M. Mercier
David S. Ragan
M.H. (Mike) Shaikh
Thomas G. Simmons
Robert A. Wilson

Officers

Robert A. Wilson
President & Chief Executive Officer

M. H. (Mike) Shaikh
Secretary & Chief Financial Officer

Kenneth S. Meek
Vice President Exploration

David S. Ragan
Vice President Operations

Auditors

Stan Peloski
Chartered Accountant

Solicitors

MacKimmie Matthews
Barristers & Solicitors
Calgary, Alberta

Bankers

Royal Bank of Canada
Calgary, Alberta

Alberta Stock Exchange Listing

Symbol: "VRG"

Abbreviations

BBLS - Barrels
Bcf - billion cubic feet
BOE - barrels of oil equivalent
BOPD - barrels of oil per day
Mbbl - thousand barrels
MSTB - thousand barrels
M$ - thousand dollars
NPV - Net Present Value

CORPORATE PROFILE

Virginia Energy Corporation is a junior oil and gas company based in Calgary, Alberta. The Company was formed in April, 1996 as a Junior Capital Pool company under the Alberta Stock Exchange regulations and began trading on May 24, 1996. On August 1, 1996, Virginia Energy acquired a 100% working interest in 640 acres in the Virginia Hills area, a 75% working interest in 160 acres in the Zama Lake area and a 10% working interest in a South Sturgeon Lake property that included 2 producing wells (net 7 bopd to the Company's interest) as our "major transaction".

On December 30, 1996, we successfully completed via prospectus dated November 28, 1996 the public placement of common and flow- through common shares grossing $1,881,294.75. These funds were invested in drilling and/or recompleting 5 gross wells (2.8 net wells). Two of these wells (1.75 net) were dry holes. We currently have 4 gross (1.05 net) oil wells producing about 50 bopd net to Virginia.

ANNUAL MEETING

The annual general and special meeting of shareholders will be held on June 19, 1998 at 2:30 pm in the boardroom at MacKimmie Matthews, Suite 700, 401 - 9th Avenue SW, Calgary, Alberta.

MANAGEMENT PHILOSOPHY

Our philosophy has been to create cash flow through the acquisition and development of high quality oil bearing reservoirs (primarily of Devonian age) in the northern part of Alberta. We intend to achieve a balance between prolific shorter life Zama reefs and the longer term stable production that we expect to obtain in Virginia Hills and Sturgeon Lake. The Company is expecting to focus on developing the Sturgeon Lake property over the next three years.

REPORT TO SHAREHOLDERS

On December 30, 1996, we successfully completed via prospectus dated November 28, 1996 the public placement of common and flow- through common shares grossing $1,881,294.75. These funds were used in the Company's 1997 development drilling program.

With the funding in place, Virginia began the development of its Zama Lake area properties by acquiring 3-D seismic on several of our prospects. The seismic confirmed the position of the targeted Devonian reef structures previously located by geological mapping.

Drilling on our first prospect began at the end of March 1997 on the first Zama Lake well (Virgo 9-2) and the recompletion of the second well (Amber 8-7) commenced in early April. The first well hit the reef exactly on target. Unfortunately the reservoir was not capable of producing commercial quantities of oil. The well was abandoned in October. The second well (Amber 8-7) was successful and is currently producing 44 bopd gross (33 bopd net). The high demand for all drilling associated services substantially increased the cost of exploiting these prospects. As a result the remaining Zama area wells will be drilled as access and economic conditions permit.

We participated in the drilling of two horizontal wells in the Sturgeon Lake South property. On completion of the second well Virginia Energy earned a 10% working interest in the 4900 acres (approximately) leased from the Sturgeon Lake Indian Band and in the 1000 acres leased from the Crown.

In addition to the above, we acquired two suspended wells from a major oil company. The one in Rainbow Lake South contains significant gas reserves.

The net result of the 1997 drilling and lease acquisition program is a 3 fold increase in Virginia Energy's estimated reserves to 1.88 million barrels oil equivalent, of which 18% is associated with natural gas. Production increased from 7 bopd to 50 bopd which is not up to our expectations due primarily to production optimization problems in Sturgeon Lake.

During 1998 we will place strong emphasis on improving the production from our current Sturgeon Lake wells. In our opinion, this field is significantly under performing. Once this problem has been rectified additional drilling will be undertaken to begin the exploitation of the substantial Leduc and Nisku reserves there.

On behalf of the Board of Directors,

R. A. Wilson
President and CEO

THE YEAR IN REVIEW

During 1997 Virginia Energy recorded a negative cash flow of $8,891 on gross revenues of $276,517. After operating expenses of $176,216, G & A costs of $109,192 and depletion expense of $47,578 the company incurred a net loss of $56,469 for 1997.

CAPITAL SPENDING

Capital spending was made up of the following:

- drilling, completing and equipping 5 gross (2.8 net) wells, of which 2 gross (1.75 net) were abandoned.
- acquisition of 640 acres of Crown oil and gas leases in the Zama Lake area
- acquisition of 640 acres of Crown oil and gas leases in Virginia Hills adjacent to our other leases.
- acquisition of a shut-in Rainbow Lake South gas well (100% interest)

MAJOR PROJECTS

VIRGINIA HILLS

The purchase of 640 acres of Crown land has increased our land position to 1440 acres. Development will most likely be done in 1999 or 2000 via a horizontal reentry of an existing well to demonstrate the effectiveness of this methodology in exploiting the substantial reserves located in our Virginia Hills properties.

STURGEON LAKE

We earned a 10% working interest in the 5900 acre Sturgeon Lake leases by participating in the drilling of two horizontal reentry wells during 1997. The first well was drilled into the Leduc D-3 Devonian reef. The second well was drilled into the Nisku D-2 Devonian reef. These wells plus one vertical well are currently producing about 170 bopd gross (17 bopd net). This rate is substantially below that expected for these reservoirs. The field operator is currently evaluating methods to improve the production level from these wells before additional drilling is undertaken.

ZAMA LAKE

Virginia Energy began the development drilling and recompletion program at the end of March 1997. Two wells (Virgo 9-2 and 16-2) were drilled directionally from an existing cased hole into the Devonian reef. The reef was encountered on target but failed to have the necessary porosity for commercial production. Both these wells were abandoned.

The Amber 8-7 reentry well (75% working interest) was completed successfully and was put on production in June. The well was shut-in in December for reservoir evaluation and subsequent (March '98) remedial work. This well is currently producing 33 bopd net to Virginia. The remaining Zama area prospects will be drilled as access and economic conditions permit. Our technical team has identified several more Keg River pinnacle reef prospects which will be added to our inventory as the leases become available.

RAINBOW SOUTH

We acquired the Rains 6-2 shut-in gas well as of October 1997. This well has been evaluated via well logs and production testing to have recoverable reserves of 1.6 Bcf of natural gas and likely average production in excess of 1.0 MMscf/d for the first year. This well is about 6 km from the nearest tie-in point.

PRODUCTION

The Company had three producing oil wells at the end of 1997 from which the Company's working interest was 29 bopd at year end. The Zama Lake well (Amber 8-7) is not included in these numbers as it was shut in for reservoir evaluation at year end. This well was placed back on production in April and is currently producing at 33 bopd net to Virginia.

LAND

At December 31, 1997, the Company had interests in 9260 gross acres (3830 net acres) of mineral leases all of which were in Northern and West Central Alberta.

RESERVES

Virginia's reserves have been evaluated effective October 1, 1997 by the independent engineering firm of Chapman Petroleum Engineering Ltd. (Chapman). The following table summarizes the findings of the Chapman report. The Net Present Value is on an escalated price basis before income tax discounted at 15%.

	Oil (MSTB)	Gas (MMscf)	NGL (Mbbl)	BOE (MSTB)	NPV (M$)
Proven Producing	298.5	589.6	0.0	357.5	2277
Proven Non-Producing	0.0	1580.2	42.8	200.8	1157
Total Proven	298.5	2169.8	42.8	558.3	3434
Probable	2471.8	1073.8	73.7	2652.9	21379
Proven Plus Probable	2770.3	3243.6	116.5	3211.2	24813
Less 50% Probable	1235.9	536.9	36.9	1326.5	10689
Proven Plus 50% Probable	1534.4	2706.7	79.6	1884.2	14124

NET ASSET VALUE

Based on the independent evaluation of the Company's proven and half probable reserves, discounted at 15 percent, Virginia's net asset value was $0.93 per share.

Proved plus 1/2 probable reserves discounted at 15% before tax as of October 1, 1997	$	14,124,000.
Working capital (as at December 31, 1997)	$	58,268.
Net asset value	$	14,182,268.*
Net asset value per common share as at December 31, 1997	$	0.93*

*Reserves valued as of October 1, 1997

FINANCIAL REPORT

MANAGEMENT'S REPORT

The annual report and financial statements have been prepared by management and approved by the Board of Directors. The financial statements have been prepared in accordance with generally accepted accounting principles. Management acknowledges responsibility for the fairness, integrity and objectivity of all financial information contained in the annual report, including the financial statements.

Robert A. Wilson
President & Chief Executive Officer

M. H. Shaikh
Secretary & Chief financial Officer

AUDITOR'S REPORT

To the Shareholders of Virginia Energy Corporation.

I have audited the balance sheets of Virginia Energy Corporation as at December 31, 1997 and 1996 and the statements of operations and deficit and changes in financial position for the years then ended. These financial statements are the responsibility of the Corporation's management. My responsibility is to express an opinion on these financial statements based on my audits.

I conducted my audits in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1997 and 1996 and the results of its operations and changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Calgary, Alberta
April 30, 1998

Stan Peloski
Chartered Accountant

VIRGINIA ENERGY CORPORATION

Balance Sheets
December 31, 1997 and 1996

ASSETS

	1997	1996
Current		
Cash and short-term deposits	$ 237,801	$ 2,011,651
Accounts receivable	48,024	45,579
Prepaid expenses	44,800	20,044
	330,625	2,077,274
Petroleum and natural gas properties (Note 3)	1,667,516	438,339
	$ 1,998,141	$ 2,515,613

LIABILITIES AND SHAREHOLDERS' EQUITY

	1997	1996
Current		
Accounts payable and accrued liabilities	$ 272,357	$ 80,817
Provision for site restoration	2,691	390
	275,048	81,207
Shareholders' equity		
Share capital (Note 4)	1,808,851	2,463,695
Deficit	(85,758)	(29,289)
	1,723,093	2,434,406
	$ 1,998,141	$ 2,515,613

Approved on behalf of the Board:

Robert A. Wilson, Director

M.H. (Mike) Shaikh, Director

"See accompanying Notes"

VIRGINIA ENERGY CORPORATION

Statement of Operations and Deficit

For the Years Ended December 31, 1997 and 1996

	1997	1996
Revenue		
Petroleum and natural gas sales, net of royalties	$ 227,789	$ 25,205
Alberta royalty tax credit	3,597	-
Interest	45,131	10,603
	276,517	35,808
Expenses		
Operating	138,340	20,843
Taxes and licenses	37,876	-
Consulting fees	31,181	11,310
Professional fees	30,039	10,147
Investor relations	17,966	7,782
Geological and engineering	11,302	-
Travel and accommodation	7,936	4,482
Office	4,941	4,314
Rent	3,449	1,400
Insurance	1,113	-
Meals and entertainment	508	363
Memberships	444	250
Bank charges and interest	313	244
Depletion	47,578	3,962
	332,986	65,097
Net loss	(56,469)	(29,289)
Deficit, beginning of year	(29,289)	-
Deficit, end of year	$ (85,758)	$ (29,289)
Net loss per share	$ 0.00	$ 0.00

"See accompanying Notes"

VIRGINIA ENERGY CORPORATION

Statement of Changes in Financial Position
For the Years Ended December 31, 1997 and 1996

	1997	1996
Operating activities		
Net loss	$ (56,469)	$ (29,289)
Add non-cash item		
Depletion	47,578	3,962
Cash flow deficiency from operations	(8,891)	(25,327)
Net change in non-cash working capital	164,339	15,194
	155,448	(10,133)
Financing activities		
Issuance of common shares	135,000	2,731,375
Share issuance costs	(18,051)	(267,680)
	116,949	2,463,695
Investing activity		
Acquisition of petroleum and natural gas properties	(2,046,247)	(441,911)
Increase (decrease) in cash	(1,773,850)	2,011,651
Cash and short-term deposits, beginning of year	2,011,651	-
Cash and short-term deposits, end of year	$ 237,801	$ 2,011,651
Cash and short term deposits is comprised of the following		
Cash (cheques issued in excess of bank balance)	$ (119,805)	$ 36,414
Short-term deposits	357,606	1,975,237
	$ 237,801	$ 2,011,651

"See accompanying Notes"

VIRGINIA ENERGY CORPORATION
Notes to Financial Statements
For the Years Ended December 31, 1997 and 1996

1. **Incorporation**

The Corporation was incorporated as 679601 Alberta Inc. under the laws of the Province of Alberta on January 2, 1996. On February 15, 1996 the Corporation filed Articles of Amendment and changed its name to Virginia Energy Corporation. The Corporation is engaged in the exploration and development of petroleum and natural gas properties.

The Corporation was classified as a Junior Capital Pool corporation as defined in Alberta Securities Commission Policy 4.11. On July 31, 1996 the Corporation completed its major transaction with the acquisition of petroleum and natural gas properties, as described in Note 3. Accordingly, the Corporation has been transferred to the senior board on the Alberta Stock Exchange.

2. **Summary of significant accounting policies**

The financial statements of the Corporation have been prepared in accordance with accounting principles generally accepted in Canada. The more significant accounting policies are the following:

a) Petroleum and natural gas properties

The Corporation follows the full cost method of accounting whereby all costs associated with the exploration for and development of petroleum and natural gas reserves are capitalized into a single Canadian cost centre and charged against earnings as set out below. Such costs include lease acquisition, geological and geophysical, carrying charges of non-producing properties and costs of drilling both productive and non-productive wells and related overhead charges.

Gains or losses are not recognized upon disposition of petroleum and natural gas properties unless crediting the proceeds against accumulated costs would result in a change in the rate of depletion of 20% or more.

Depletion is provided on costs accumulated in a producing cost centre using the unit of production method. For purposes of the depletion calculation, gross proved petroleum and natural gas reserves, as determined by outside consultants, are converted to a common unit of measure on the basis of their approximate energy content.

The Corporation periodically reviews the costs associated with unproved properties and preproduction stage cost centres to determine whether they are likely to be recovered. When costs are not likely to be recovered, an impairment allowance is made.

The net carrying costs of the Corporation's petroleum and natural gas properties in producing the cost centre is limited to an estimated recoverable amount. This amount is the aggregate of future net revenues from proved reserves and the costs of undeveloped properties, net of impairment allowances, less future general and administrative costs, financing costs, future site restoration costs and income taxes. Future net revenues have been calculated using prices in effect at the Corporation's year end without escalation or discounting.

b) Joint venture accounting

Substantially all of the Corporation's petroleum and natural gas exploration and production activities are conducted jointly with others and, accordingly, the accounts reflect only the Corporation's proportionate interest in such activities.

c) Future removal and site restoration costs

Estimated future removal and site restoration costs are provided for over the life of the proved reserves on a unit-of-production basis. Costs are estimated by management in consultation with engineers based on current regulations, costs, technology and industry standards. The annual charge is included in depletion expense and actual future removal and site restoration expenditures are charged to the accumulated provision account as incurred.

VIRGINIA ENERGY CORPORATION
Notes to Financial Statements
For the Years Ended December 31, 1997 and 1996

2. Summary of significant accounting policies (continued)

d) Flow-through shares

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. Petroleum and natural gas properties and equipment and share capital are reduced by the estimated income taxes related to the renounced income tax deductions when the expenditures are incurred.

e) Income taxes

The Corporation follows the tax allocation method of accounting for corporate income taxes. Deferred taxes are provided to the extent that current taxes have been reduced by claiming amounts, primarily exploration and development costs and capital cost allowance, in excess of the related depletion and amortization recorded in the financial statements.

f) Per share data

Net loss per share is calculated based on the weighted average number of common shares outstanding during the year. The weighted average number of common shares outstanding during the year is 14,805,227 (1996 - 5,966,785). Fully diluted net loss per share is not disclosed as the effects of the assumed share purchase options and warrants as disclosed in Note 4 would be antidilutive.

3. Petroleum and natural gas properties

			1997	1996
	Cost	Accumulated Depletion	Net Book Value	Net Book Value
Leases and rights	$ 1,538,706	$ 43,792	$ 1,494,914	$ 364,635
Lease and well equipment	177,658	5,056	172,602	73,704
	$ 1,716,364	$ 48,848	$ 1,667,516	$ 438,339

VIRGINIA ENERGY CORPORATION
Notes to Financial Statements
For the Years Ended December 31, 1997 and 1996

3. **Petroleum and natural gas properties** (continued)

Costs associated with unproven properties excluded from costs subject to depletion for 1997 totalled $419,681 (1996 - Nil).

On July 31, 1996, the Corporation acquired certain petroleum and natural gas properties in contemplation of completing its major transaction in accordance with Alberta Securities Commission Policy 4.11. As consideration, the Corporation issued 2,825,000 common shares for $250,000. For corporate purposes, these properties were valued at $1,412,500 and therefore, the parties to the transaction determined the value of the common shares exchanged for these properties to be $1,412,500. For accounting purposes, the acquisition was recorded at $250,000. The transaction was effected pursuant to subsection 85(1) of the Income Tax Act whereby the Corporation and the vendor elected on an agreed amount of $149,000. Accordingly, $101,000 of cost is not subject to deduction for income tax purposes.

4. **Share capital**

Authorized

Unlimited number of voting common shares
Unlimited number of first preferred shares
Unlimited number of second preferred shares

The first and second preferred shares may be issued in one or more series and the directors are authorized to fix the number of shares in each series and to determine the designation, rights, privileges, restrictions and conditions attached to the shares of each series.

Issued and outstanding common shares

	Number of Shares	Amount
Issued for cash to Directors and a Trust in which a director is the Trustee	2,000,000	$ 100,000
Issued for cash	1,000,000	100,000
Issued for cash	3,000,000	300,000
For purchase of petroleum and natural gas properties	2,825,000	250,000
For purchase of petroleum and natural gas properties	166,800	100,080
Issued for cash	797,000	239,100
Flow-through common shares	4,691,985	1,642,195
Share issuance costs	-	(267,680)
Balance December 31, 1996	14,480,785	2,463,695
Issued for cash pursuant to share purchase option		
Director	50,000	5,000
Agent	300,000	30,000
Flow-through shares issued for cash	285,714	100,000
Share issuance costs	-	(18,051)
Tax effect of flow-through	-	(771,793)
Balance December 31, 1997	15,116,499	$ 1,808,851

VIRGINIA ENERGY CORPORATION

Notes to Financial Statements
For the Years Ended December 31, 1997 and 1996

4. **Share capital** (continued)

Pursuant to Escrow Agreements, 2,000,000 common shares issued to the founders of the Corporation and 2,118,750 common shares issued in consideration of the purchase of petroleum and natural gas properties are held in escrow by Montreal Trust. The common shares shall be released in equal allotments on each of July 31, 1997, 1998 and 1999.

In connection with the issuance of the flow-through common shares, no qualifying expenditures were incurred in 1996. How ever, the Corporation incurred $1,742,195 in qualifying expenditures in 1997.

Prospectus offerings

Pursuant to a prospectus dated April 3, 1996, the Corporation issued 3,000,000 common shares at a price of $0.10 per common share for total consideration of $300,000.

Pursuant to a prospectus dated November 28, 1996, the Corporation issued 797,000 "A" Units and 4,691,985 "B" Units. Each "A" Unit consisted of one common share and one common share purchase warrant at $0.30 per unit. Each "B" Unit consisted of one common share on a flow-through basis and one common share purchase warrant at $0.35 per unit. Total proceeds from the issuance of "A" Units and "B" Units was $239,100 and $1,642,195, respectively.

Stock Options

The Corporation established a Stock Option Plan and granted options to directors as follows:

Number of stock options	Exercise price per share	Expiry date
200,000	$0.10	April 22, 2001
900,000	$0.20	June 27, 2002

Warrants

Pursuant to a prospectus dated November 28, 1996, the Corporation issued 5,488,985 share purchase warrants to unit subscribers. Two share purchase warrants entitle the holder to acquire one common share at a price of $0.50 until November 27, 1997. All of these warrants expired without being exercised.

Pursuant to Agent's Warrants Agreements dated December 20, 1996 and December 30, 1996, the Corporation issued 548,899 share purchase warrants to Canaccord Capital Corporation (the "Agent"). Each share purchase warrant enables the Agent to purchase one common share at a price of $0.33. 345,050 warrants expire on June 20, 1998 and 203,849 on June 30, 1998.

VIRGINIA ENERGY CORPORATION
Notes to Financial Statements
For the Years Ended December 31, 1997 and 1996

5. Income taxes

a) The Corporation has incurred income tax losses which are available to offset income from operations to the extent of $175,681. The value of these loss carry forwards has not been recorded in these financial statements. These losses expire in the following years:

2003	$78,535
2004	$97,146

b) The provision for income taxes differs from the result which would be obtained by applying the combined Canadian Federal and Provincial income tax rate of approximately 44.3% to loss before income taxes. The difference results from the following:

	1997	1996
Computed expected recovery	$ (25,016)	$ (12,975)
Increase (decrease) in taxes resulting from the following:		
Crown royalties, net of Alberta royalty tax credit	1,976	-
Depletion and amortization in excess of tax deduction	5,207	1,755
Other	(25,203)	(23,571)
Losses for which no tax benefit is recorded	43,036	34,791
Provision for income taxes	$ -	$ -

At December 31, 1997, the Corporation had net book value in excess of income tax pools in the amount of $1,058,379 (1996 - $97,428).

VIRGINIA ENERGY CORPORATION

Notes to Financial Statements
For the Years Ended December 31, 1997 and 1996

6. Related party transactions

During the year ended December 31, 1997, the Corporation paid consulting and professional fees to companies controlled by directors of the Corporation in the amount of $75,422 (1996 - $22,362). The consulting and professional fees have been allocated as follows:

	1997	1996
Consulting fees	$ 27,500	$ 10,000
Professional fees	24,470	8,147
Petroleum and natural gas properties	23,452	4,215

7. Subsequent event

Subsequent to December 31, 1997, the Corporation sold specified assets to an arms length joint venture partner for $257,000.

8. Financial instruments

The Corporation's financial instruments that are included in the balance sheet are composed of accounts receivable, prepaid expenses and current liabilities.

(a) Fair values of financial assets and liabilities

The fair values of financial instruments that are included in the balance sheet approximate their carrying amount due to the short term maturity of those instruments.

(b) Credit risk

Virtually all of the Corporation's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks.

9. **Comparative figures**

Certain comparative figures have been reclassified to conform with the current year's presentation.

VIRGINIA ENERGY CORPORATION
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